

Preliminary Analysis of OMERS Options

Toronto Transit Commission Pension Fund Society

Purpose and Scope

This preliminary analysis has been prepared by OMERS Administration Corporation (OAC) in accordance with the Government Committee Recommendations: GM3.9 – “City Sponsored Pre-OMERS Pension Plans and the Toronto Transit Commission (TTC) Pension Fund Society”. These recommendations were adopted by City Council at its meeting of May 17-19, 2011.

This analysis is the first of a two phase initiative. This phase, a high level analysis, was intended to assist in narrowing the options to those most likely to provide efficiencies in the administration, investment and/or funding of the TTC Pension Fund Society (PFS). As of the time of writing this report, the TTC and/or the PFS did not provide required documents, in particular those containing actuarial information, necessary to perform a more fulsome analysis of the options. These documents were to be provided by June 30, 2011 according to the Work Plan. Drafts of this report were provided to the TTC/PFS for data confirmation.

Throughout this report, the OMERS Primary Pension Plan is referred to as the “OMERS Plan”. All of the information is provided to the best of OAC understanding at the time of writing, but may change over time, and does not bind OAC to any particular pricing or option. A separate analysis has been performed for the City-Sponsored Pre-OMERS pension plans which contains more detail.

In addition, subsequent to the submission of the Work Plan to Council, the PFS made significant plan amendments to become a jointly sponsored pension plan (JSPP) and was granted (by provincial regulation) exemption from solvency payments. Under its newly restructured status, all decisions related to the PFS (including any of the options below) are made by the PFS. While the PFS was previously governed by employer and member representatives on its Board, JSPP status confirms its joint sponsorship (member and employer shared responsibility for funding and plan amendments).

OMERS

OMERS is the pension plan for City of Toronto employees hired since July 1, 1968. The OMERS Plan is:

- a jointly-sponsored pension plan with close to a fifty year tradition of strong employer/member governance;
- a large multi-employer defined benefit plan with more than 400,000 members from about 930 employers;
- a large, experienced pension fund investor pursuing a global investment mandate with total assets of \$53 billion as of December 2010; and
- a direct investor of over \$25 billion in the Ontario and other regional Canadian economies through major infrastructure, real estate and energy assets.

Executive Summary

The Work Plan and attached document list approved by City Council, required the TTC/PFS to provide a range of documents and information to OAC for analysis. OMERS information and analysis of the limited PFS information is provided.

The TTC/PFS provided information about plan terms and accounting information provided to members annually.

The TTC/PFS did not provide the following key information, which is key to analysis of Options 2 and 3 in particular:

- Determination of legal authority of TTC, PFS and Council
- Funding information: solvency and going concern funded status, membership data
- Investment performance information: i.e., asset mix, returns history, expenses history
- Administration information: details of PFS administration expenses

Options under Consideration

The three options being considered with OMERS are:

- Option 1: Investment Management through OMERS
- Option 2: Pension Payroll and Member Services through OMERS
- Option 3: Full Merger with OMERS

Option 1: Investment Management through OMERS

This option involves retaining OMERS for the purpose of investment management in whole or in part. The sponsor(s) of the PFS would continue to be responsible for all administration functions and any funding requirements. However, the TTC/PFS did not provide information about the legal authority to make these decisions according to the Work Plan.

OMERS Investment Management

OMERS Investment Management Inc. (OIM) was founded in 2009 in response to legislative authority granted to the OMERS Administration Corporation (OAC) to provide investment products and investment management services through an authorized subsidiary.

OIM offers eligible clients access to one of two arrangements:

- T Contract - An investment contract that pays the annual total fund return earned by the OMERS Plan. This offering is targeted at funds with \$100 million to \$500 million of capital that can be fully invested in an OMERS Total Fund Return contract, less cash required to meet current obligations.
- S Contract – An investment contract targeted at larger funds (>\$500 million), looking to gain exposure to one of the following private market returns:
 - The annual return earned by Borealis Infrastructure
 - The annual return earned by Oxford Properties
 - The annual return earned by OMERS Private Equity (OPE) – in relation to the directly managed assets in the OPE portfolio.

Specific terms apply to the contractual arrangements with respect to maximum limits and timing, which would need to be considered in the context of the PFS. Our basic understanding of the PFS fund indicates it would be too large to qualify for a T contract, but would be large enough to qualify for an S contract.

The information set out in this report cannot bind either the PFS or OIM, but is provided as relevant to the consideration of such investment products.

While we did not receive confirmation of the authority to make investment decisions as set out in the Work Plan, it is likely this authority resides with the PFS Board. The PFS Board and OIM would require detailed discussion about the terms and conditions of the OIM S contract prior to coming to agreement. As a result, this option may take some time to implement (12–24 months).

Comparisons between OMERS and the PFS

The TTC/PFS did not provide information to allow for a comparison. Key information on OMERS is provided.

- 1) Past investment performance (Exhibit I)
- 2) Investment management fees (Exhibit I)
 - The fixed fees under the T and S Contracts are paid annually and would be higher than the OMERS Plan's investment management expenses. OMERS investment management expenses are listed for reference.
- 3) Asset mix (Exhibit II)
 - OMERS asset mix is allocated according to public and private markets. OMERS has developed this approach to achieve long-term, stable returns with low volatility, building on our asset size of \$53 Billion as of December 31, 2010.
- 4) Membership data (Exhibit III)
 - Incomplete data on the PFS is included from a June 2011 newsletter. OMERS data is provided for reference.

Investment changes do not generally require plan amendments, but may require changes to the Statement of Investment Policies and Procedures for the PFS. The administrators of the PFS must make such investment decisions on a fiduciary basis.

Option 2: Pension Payroll & Member Services through OMERS

This option would involve moving the responsibility for the day-to-day pension payroll of the PFS to OMERS, from TTC/PFS. This includes running the pension payroll and required payments, managing banking services for the pension plans, pension reporting, responding to pensioner inquiries.

The sponsor(s) of the PFS, would continue to be responsible for any funding requirements, providing support to the PFS Board, preparation and filing of actuarial valuation reports and all other legislative requirements. The PFS would continue to have a fiduciary responsibility to direct and manage its affairs, including the investment of assets, and provision of the actuarial valuations.

In order to provide these services, OMERS would be required to create a subsidiary for third party administration purposes. Currently, OMERS does not have a legal structure in place to do this and would require internal approvals to proceed. An implementation period of about 18-24 months would be required to set up such a structure.

Comparison of Costs

TTC/PFS did not provide documents to allow comparison. (NOTE: some information was contained in the April 13, 2011 Treasurer's Report to the Government Management Committee, however, OMERS requires the Work Plan information to provide the cost of the option.) As indicated in the Report addressing the City-Sponsored Pre-OMERS Pension Plans, there would be start up costs associated with this option that could be paid up front or amortized over a number of years.

Option 3: Full Merger with OMERS

This option involves transferring all of the assets and liabilities of the PFS into the OMERS Plan through a full merger.

A full merger option would result in the TTC and/or PFS no longer being considered sponsors. Depending on the regulatory requirements, the funding requirements of the PFS for past service benefits would be settled at the time of merger. Go forward contributions for active members would depend on the nature of future benefit accruals – it would be possible, subject to approvals, for the TTC to have OMERS-style or other benefit levels. The TTC/PFS has not provided documents (i.e., financial and member information) required to analyze this option, except for the benefit comparison. Generic comments are included relating to the applicable process.

Comparison of Benefit Provisions (Exhibit IV)

Pension benefits currently provided by the PFS are defined benefit in nature with a normal retirement age of 60. Key benefit provisions, such as early retirement and bridge benefits, are similar to the OMERS Plan. There are, however, two key exceptions:

- pension benefits payable under the OMERS Plan are automatically based on best 5 year average earnings while those payable under the PFS are based on a career average earnings with upgrades to more recent best 4 year average earnings on an ad-hoc basis; and
- pension benefits payable under the OMERS Plan are contractually indexed while those payable under the PFS are indexed only on an ad-hoc basis.

Comparison of Financial Position at December 31, 2010 and Minimum Funding Requirements for 2011 (Exhibit V)

Merger Under New Rules (Bill 236)

The potential asset transfer and merger of the PFS with the OMERS Plan would likely be subject to several new sections of the PBA. However, as of the date of this report, the Bill 236 revisions have not been proclaimed and the corresponding regulations have not been released.

Any plan merger would take approximately 12–24 months to complete. Given that time horizon and the strong likelihood that the regulations will be in effect during that time, OMERS would focus attention on the new rules. A merger under the current rules would be more cumbersome and unrealistic with the new rules in development.

Bill 236 would facilitate the merger of the PFS and the OMERS Plans as follows:

- Mergers would more readily take place without extensive trust law reviews.
- Requirements to provide the same benefits for transferred active members would be relaxed. Benefits would still be the same for retired members and deferred vested members as described above. Improvements would also be possible depending on the funding rules.
- The requirements for funding and related rules for mergers are to be prescribed.
- The Superintendent must provide consent if the transfer meets the key requirements which are yet to be finalized (i.e., less discretion for the Superintendent compared to current rules).

OMERS and the TTC/PFS therefore could have an opportunity to provide important input through examples and discussion with Ministry of Finance, on the requirements of the new asset transfer regulations. Key issues include how to address deficits on a merger, small plan/large plan mergers, and actuarial assumptions used to determine asset transfer amounts.

Conclusion and Next Steps

The TTC/PFS did not provide information necessary to analyze any of the options, even on a high-level basis.

Exhibit I – Historical Asset Returns and Expenses

GROSS RETURNS	OMERS	TTC PFS
2010	12.0%	10.8%
2009	10.6%	13.6%
2008	-15.3%	-15.5%
2007	8.7%	---
2006	16.4%	---
2005	16.0%	---
2004	12.1%	---
2003	12.7%	---
2002	-7.1%	---
Av 5 yr to 2010	5.83%	4.0%
Av 7 yr to 2010	8.11%	---
INVESTMENT M'GMT EXPENSES		
2010	.64%	---
2009	.55%	---
2008	.45%	---
2007	.40%	---
2006	.39%	---

GROSS RETURNS	OMERS Primary Pension Plan				
	Overall Plan	Capital Markets	Private Equity	Infrastructure	Oxford (Real Estate)
2010	12.0%	11.0%	22.2%	10.1%	7.5%
2009	10.6%	11.0%	13.9%	10.9%	1.3%
2008	-15.3%	-19.5%	-13.7%	11.5%	6.0%
2007	8.7%	2.6%	18.6%	12.4%	22.9%
2006	16.4%	16.2%	17.7%	14.0%	26.2%
2005	16.0%	12.6%	23.2%	23.2%	26.0%

Exhibit II – Asset Mixes at December 2010

Asset Mix for OMERS At December 2010	
Asset Classes	Actual Asset Mix
Public Markets	60.1%
Private Markets	
• Private Equity	12.7%
• Infrastructure	15.5%
• Real estate	11.7%
• Total	39.9%
Total	100.0%

Asset Mix for TTC PFS At December 2010	
Asset Classes	Actual Asset Mix
Equity	52.6%
Bonds & Fixed Income	43.9%
Real Estate	4.4%
Cash & Short-Term Equivalents	-1.2%
Infrastructure	0.3%
Total	100.0%

Exhibit III – Membership Data at December 31, 2010

MEMBERSHIP	OMERS	TTC PFS
Retirees	93,202 (Avg Age = 71.3)*	6,307 (including survivors)
Survivors	20,364 (Avg Age = 78.9)*	Included above
Deferred	36,907	Not available
Actives	259,273	12,584
Total	409,746	18,891

*NRA65

Exhibit IV – Indexation Comparison

PLAN PROVISIONS	OMERS	TTC PFS
Indexing Provision	Contractual	Ad hoc
Amounts		
2010	1.61%	Not available
2009	0.37%	“
2008	2.51%	“
2007	1.99%	“
2006	0.70% ¹	“
Average: 5 years	1.4%	“

¹ Prior to the change to the OMERS Plan to align its indexing provision with that similar to the CPP.

General Benefits Comparison

PLAN PROVISION	TTC Plan	OMERS
MEMBERSHIP	CFT mandatory after 6 months OTCFT optional after 6 months.	CFT mandatory OTCFT optional (PBA 2 years) or mandatory.
NRA	Age 60.	Age 65/ 60 for Fire & Police
NORMAL FORMULA	Integrated 1.6 / 2%	1.325 / 2%
EARNINGS Basis	Best 4 prior to 2005	Best 5 continuous
AVERAGE YMPE	Same period as Earnings basis	Final 5
BRIDGE BENEFIT	the better of : (1) 0.4%, <i>plus</i> 0.4% of PE below YMPE for years after BP; or, (2) \$143.20 x credited service, per year	0.675% of lesser of member's Best 5 and Average YMPE.
MAX. SERVICE ACCRUAL	35 year limit only applies to pre-Jan 1, 1992 service	35 years
EARLIEST RETIREMENT AGE	Age 50, or after 29 years' service.	Age 55
Unreduced EARLY RETIREMENT	80 Factor (min 30 yr service)	30 service/ 65age/90 Factor
Reduced EARLY RETIREMENT	Not greater than 5%/yr. Actuarial table based on better of results for age and service. Bridge reduced – service based.	5%/yr from earliest unprojected milestone • Age 65/ 90 Factor/ 30 years service
PRE-RETIREMENT DEATH BENEFITS	Survivor normal for J+S 60% with optional forms equal at least to member CV. No child benefits.	Survivor 66 2/3% plus 10% for children. (integrated)
POST-RETIREMENT DEATH BENEFIT	Survivor: 60% with optional forms. Single life guaranteed 10 (optional for 15) Residual to beneficiary (or estate).	Survivor: 66 2/3% plus 10% for each child up to 100%. Single life only Residual to beneficiary (or estate).
DISABILITY BENEFITS	<ul style="list-style-type: none"> Credited service includes approved leaves Pension option (partial reduction) if permanent only after 7 years service. 	<ul style="list-style-type: none"> Waiver contribution and credit of service Pension option if permanent (unreduced).
INDEXING	Post retirement Ad hoc, limited to CPI.	Guaranteed Pre and Post-retirement indexing 100% of CPI to a maximum of 6% with carry forward. • Some exclusion for post 2012 service

Exhibit V – Comparison of Financial Position at December 31, 2010

Dec 31, 2010 Valuation Results (\$ Millions)	OMERS	TTC PFS
Going Concern		
Assets	\$55,568	Not available
Liabilities	\$60,035	“
Surplus/(Deficit)	(\$4,467)	“
Solvency		
Solvency assets	\$57,214	“
Solvency liabilities	\$56,203	“
Solvency surplus/deficit	---	“

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Dec 31, 2010 Valuation Results \$(millions)	OMERS	TTC PFS
Key Assumptions		
Real Rate of Return	4.25%	Not available
Inflation	2.25%	“
Mortality	UP94 with generational mortality projection using Scale AA (multiplier of .85 for females)	“